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IN THE

Supreme Court of the United States

Term, 1950.

No. 589

AMERICAN BANTAM CAR COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

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COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

American Bantam Car Company, by its counsel, David Berger, prays that a writ of certiorari issue to review the judgment of the Court of Appeals for the Third Circuit entered in this case.

Opinions Below.

The opinion of the Tax Court (R. 123) is reported at 11 T. C. 397 and the opinion of the Court of Appeals (R. 143) is reported at 177 F. 2d 513.

Jurisdiction.

The judgment of the Court of Appeals was entered on November 14, 1949 (R. 144). The jurisdiction of this Court is invoked under Section 1254 (1) of title 28 U. S. C., 28 U. S. C. A. §1254 (1).

Question Presented.

The question is whether, in computing deductions for depreciation on assets acquired in 1936 by petitioner, a newly organized corporation, in exchange for its stock, petitioner must take as the basis of the assets so acquired the basis thereof in the hands of the transferors or whether the basis for depreciation is the cost to petitioner of these assets. The answer to this question turns on whether the exchange by which petitioner received the assets was one in which gain or loss is *not* recognized under the provisions of section 112 (b) (5) of the Revenue Act of 1936. This section is applicable and the exchange free from tax only if the transferors had "control" of the corporation immediately after the exchange. The transferors had such "control" only if all of the following steps in the consummation of the exchange are *not* regarded as integrated parts of a single plan; conversely if they are regarded as integrated parts of a single plan, the transferors had no such "control":

Owners of a manufacturing plant orally agreed with certain underwriters to a plan under which (a) the owners would organize a corporation and would transfer the plant to the corporation in exchange for shares of voting common stock of the corporation; (b) the corporation would then offer shares of its voting preferred stock to the public through the underwriters who would be entitled to commissions on the shares sold; and (c) upon completion of the public offering the owners would transfer to the underwriters as additional compensation a portion of the common shares originally issued to the owners. On advice of counsel in order to avoid taxes the mutual commitments were not reduced to writing until shortly after completion of step (a) above. Steps (b) and (c) were consummated substantially as originally planned, although two of the underwriters withdrew, and after the transfer of common

shares to the remaining broker, the owners had no "control" because they held less than 80% of the issued and outstanding common stock.

Statutes Involved.

The pertinent sections of the Internal Revenue Code are as follows:

Sec. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

• • •

(8) *Property acquired by issuance of stock or as paid-in surplus.*—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section 112 (b) (5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), or

• • •

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

• • •

(26 U. S. C. 1946 ed., Sec. 113.)

Revenue Act of 1936, c. 690, 49 Stat. 1648:

Sec. 112. RECOGNITION OF GAIN OR LOSS.

* * *

(b) *Exchanges Solely in Kind.*—

* * *

(5) *Transfer to corporation controlled by transferor.*—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

* * *

(h) *Definition of Control.*—As used in this section the term "control" means the ownership of stock possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

Statement.

The basic facts as stipulated (R. 16-87) were found by the Tax Court (R. 118-123) and may be summarized as follows:

In June, 1934, American Austin Car Company, Inc., a Delaware corporation (hereinafter called "Austin"), voluntarily instituted proceedings for its reorganization under Section 77B of the National Bankruptcy Act (R. 19). In

1935, the District Court concluded that no reorganization could be effected and directed liquidation (R. 21). In August, 1935, the liquidating trustee, with the approval of the District Court, sold the Austin assets to R. S. Evans (Evans), Martin Tow (Tow) and W. A. Ward, Jr. (Ward) (hereinafter referred to collectively as the "Associates"), for $5,000 in cash, subject, however, to certain liabilities aggregating $219,099.83, consisting of a mortgage of $150,000, accrued interest thereon of approximately $36,000 and accrued and unpaid real estate taxes of approximately $33,100 (R. 21-22). The Associates thereafter obtained agreements from the holder of the mortgage and the municipal taxing authorities under which the liabilities to which the Austin assets were subject could be satisfied in full by payments aggregating $138,650.66, plus interest accruing after September 15, 1935, on $100,000, the amount for which the mortgage could be satisfied (R. 22-23).

Prior to the incorporation of petitioner on June 2, 1936, the Associates conceived a plan of organizing and financing with public funds a corporation to take over the Austin assets and operate the business formerly carried on by Austin (R. 27).

The Tax Court expressly found that (R. 118-119):

> "A general plan of organizing the petitioner to take over the Austin assets from the associates was conceived in May 1936. The plan contemplated the organization of a Pennsylvania corporation to be known as the American Bantam Car Company. The salient points of the contemplated plan included the following: the associates were to receive in exchange for their transfer of Austin assets to petitioner 300,000 shares of no par common stock, which would comprise all of the petitioner's stock upon its issuance to the associates; transfer to petitioner of such assets would be subject to liabilities totaling $219,093.83; 90,000 shares of petitioner's preference stock would be offered to the

public at $10 a share; the underwriters of such issue of preferred stock were to receive from the associates, in addition to their underwriting discounts and commissions, and as further compensation for their services as underwriters, certain amounts of the common stock issued to the associates as and if they affected sale to the public of certain amounts of the preference stock. *All the interested parties orally agreed to the substance of this plan prior to June 2, 1936, though there was no formal written contract between the parties at this time.*"

As the first step in consummation of the plan, petitioner was incorporated on June 2, 1936, under the laws of Pennsylvania, with an authorized capital stock of 700,000 shares, consisting of 100,000 shares of preferred stock of the par value of $10 per share, and 600,000 shares of common stock without par value (App. 23a). On June 3, 1936, as the second step in the plan, the Associates transferred the Austin assets to petitioner subject to the above-described liabilities, but with the rights acquired by the Associates from the mortgagee and municipal tax authorities to satisfy such liabilities for less than their face amounts (R. 22-23) and petitioner issued to the Associates 300,000 shares of its common stock in the following proportions (R. 24):

Tow	138,750 shares
Evans	138,750 shares
Ward	22,500 shares

This was in the same proportion as the respective interests of the Associates in the Austin assets immediately prior to the transfer (R. 24).

The next step in consummation of the plan was the execution on June 8, 1936, of *written* contracts with the brokers who were to handle the public offering (R. 25, 53, 62).

As explained, the execution of the written contract was deferred solely for purposes of tax avoidance.

A registration statement covering the offering of preferred stock was promptly filed with the Securities & Exchange Commission (R. 25) and as soon as the registration statement became effective (July 18, 1936), the offering was commenced. Sales aggregating 83,618 shares of preferred stock were effected during the period from October, 1936 to October, 1937, at prices ranging from $10 to $12 per share (R. 25-26). The offering was then terminated and in performance of their agreements with the brokers, the Associates transferred to Grant, the other brokers having withdrawn from the offering, 87,900 shares of petitioner's common stock out of the 300,000 shares originally issued to them at June 3, 1936 (R. 26, 28). This transfer to Grant was the last step in the consummation of the plan. At that time the ownership of petitioner's securities was as follows:

	Owned by the Associates	Owned by the Public	Owned by Grant
Common	212,100	1,008	86,892
Preferred	—0—	83,618	—0—

At all meetings of shareholders of petitioner the holders of each share of common stock were entitled to cast one vote for each such share of common stock held and the holders of preferred stock were entitled to cast three votes for each such share of preferred stock held (R. 29).

Immediately after consummation of the plan the Associates held approximately 70.7% of the outstanding common stock and approximately 38.5% of the total voting power of all of the outstanding stock; the public held all of the outstanding preferred stock, approximately 0.336% of the outstanding common stock and approximately 45.7% of the total voting power of all of the outstanding stock.

The Austin properties transferred to petitioner were appraised a few days prior to such transfer by the American

Appraisal Company at a value of $840,800 (R. 88-91, 103-111).

Petitioner contended that the above-described transaction in which it acquired the Austin properties was an exchange in which gain or loss was recognized; in other words, that the complete transaction was one in which property consisting of the Austin assets and public monies, was transferred to a corporation solely in exchange for voting stock, but because part of the voting stock issued under the plan was to go and in fact did go to a person who did not transfer any property to the corporation, so that immediately after the transaction the amount of stock and securities received by each of the transferors was not substantially proportionate to their interest in the transferred property immediately prior to the transfer, and because the transferors then held less than 80% of the outstanding control of each class of stock, the transaction did not come within provisions of Section 112 (b) (5) of the Revenue Act of 1936 (26 U. S. C. A., Int. Rev. Acts, 1924 to date, p. 855), as amended by Section 213 (h) of the Revenue Act of 1939 (Id. at p. 856). Petitioner contended further that the basis for depreciation of the depreciable assets so acquired was their cost: Sections 113 (a) and 114 (a) of the Revenue Act of 1936 (Id. at pp. 859 and 866); that the cost was an allocable part of the value of the securities given in exchange therefor and that the securities so issued in the instant case (200,000 shares of common stock) had a value of at least $972,104.76, i. e., $840,800, which was the value of the assets transferred, plus $131,304.76, the net amount for which the liabilities to which the assets were subject could be satisfied.

Petitioner and respondent agreed as to the allocation of cost as between depreciable and non-depreciable assets, as among the various classes of depreciable assets and as to the appropriate rates of depreciation (R. 18-19).

Respondent determined income tax, declared value excess profits tax and excess profits tax aggregating $217,856.24 for the years 1942 and 1943 deficiencies against

petitioner principally as a result of his determination that petitioner acquired the Austin assets in an exchange in which no gain or loss was recognized as a result of the application of Section 112 (b) (5) of the 1936 Revenue Act (Id. at pp. 855-6), and that petitioner's basis for depreciation was the same as in the hands of the Associates (transferors), i. e., $199,781.87 or 89.1486039% of the transferors' cost of $224,099.83 consisting of the $5,000 cash paid and the liabilities of $219,099.83, to which the assets transferred by the liquidating trustee of Austin to the Associates were subject.

The majority of the Tax Court held (R. 118-138) that the various steps outlined above were separable and not component steps of an integrated plan, conceding that if its holding in this regard were otherwise, petitioner's contention would have been sustained. Judge Hill, writing for the majority, stressed the fact that the agreement had not been reduced to writing (R. 119). Judge Leech differed with the majority and held, "In my judgment the various steps outlined in the majority opinion were integrated parts of a single plan rather than independent undertakings. The fact that the plan was not reduced to writing is unimportant, since it was carried out as orally agreed upon" (R. 137).[1] The Court of Appeals affirmed in a per curiam opinion reported at 177 F. 2d 513, holding that: "We are satisfied that for the reasons well stated in the opinion filed by Judge Hill for the Tax Court in banc" the transaction was a tax free exchange (R. 143).

Specification of Error to Be Urged.

The Court of Appeals erred in holding that the various steps taken by the parties in consummation of the exchange of Austin assets for petitioner's stock were not integrated parts of a single plan and therefore the transferors had "control" of the petitioner immediately after the exchange so that the exchange was tax free and the basis of the

[1] Following a recomputation the Tax Court handed down an order on February 2, 1949, fixing the aggregate deficiencies at $270,742.18 (R. 138).

assets of the petitioner is their cost to the transferors rather than to petitioner. The Court of Appeals further erred in refusing to remand the case to the Tax Court to find the cost to petitioner and on that cost to determine petitioner's basis for depreciation.

Reasons for Granting the Writ.

1. The decision of the Court of Appeals is in direct conflict with *Bassick v. Commissioner,* 85 F. 2d 8 (C. A. 2) and *Halliburton v. Commissioner,* 78 F. 2d 265 (C. A. 9). It also conflicts with a previous decision of the Third Circuit, itself, in *Hazeltine Corp. v. Commissioner,* 89 F. 2d 513 (C. A. 3) as well as the decision of the Tax Court in *Aviation Manufacturing Corporation,* Docket No. 754, P-H 1944 T. C. Memo., Para. 44,089. In principle, it squarely conflicts with a number of decisions which hold that the question of "control" is to be determined by the situation existing *at the time of the completion of the plan. Case v. Commissioner,* 103 F. 2d 283 (C. A. 9); *West Texas Refining and Development Co. v. Commissioner,* 68 F. 2d 77 (C. A. 10); *Briggs-Darby Const. Co. v. Commissioner,* 119 F. 2d 89 (C. A. 5); *Heberlein Patent Corp. v. U. S.,* 105 F. 2d 965 (C. A. 2). The decision of the Court of Appeals is also in direct conflict with those decisions which uphold the general principle of tax law that formalisms "which exist solely to alter tax liabilities" can neither disguise the true nature of a transaction nor affect its tax consequences. *Commissioner v. Court Holding Co.,* 324 U. S. 332; *Gregory v. Helvering,* 293 U. S. 465; *Bazley v. Commissioner,* 331 U. S. 737.

The court below made no reference to any of these cases. The Tax Court purported to distinguish *Hazeltine* and *Bassick* on the ground that in those cases there was a pre-existing written contract. This is a distinction in fact but not in law. Clearly, tax liability cannot be controlled by whether a particular contract is written or oral. *Commissioner v. Court Holding Co.,* 324 U. S. 331, 334. In petitioner's case, the Tax Court *expressly* found as a fact

that "All the interested parties orally agreed to the substance of this plan prior to June 2, 1936, though there was no formal written contract between the parties at this time" (R. 119). In essence, therefore, there is a clear conflict between the decision of the court below and the *Bassick* and *Hazeltine* cases, as well as the reasoning of this Court in *Commissioner v. Court Holding Co., supra.*

For further support, the Tax Court relies upon three decisions of the Board of Tax Appeals.[2] All three were decided prior to the *Gregory* case which put formalisms in their proper perspective for tax purposes and, in the Court of Appeals the Commissioner virtually disclaimed as to these three decisions of the Board of Tax Appeals, placing no reliance upon them. Nevertheless, the fact that they were cited with approval and relied upon by the Tax Court coupled with the fact that the Court of Appeals adopted Judge Hill's opinion wholeheartedly makes it appear that these three decisions still represent controlling law in the views of the Tax Court and the Court of Appeals, even if not in the eyes of the Commissioner. The resultant confusion should be eliminated by this Court's decision of petitioner's case.

2. The judgment of the Court of Appeals, expressly relying upon Judge Hill's opinion (R. 143) misapplies the "single integrated transaction" principle in violation of the reasoning of this Court in *Gregory v. Helvering,* 293 U. S. 465 and *Bazley v. Commissioner,* 331 U. S. 737, 743, where this Court held that an arrangement which took a particular form because another form would "undoubtedly have been taxable" cannot "claim the shelter of the immunity of a recapitalization—reorganization". In this case, it is clear beyond doubt that had the arrangement between the parties been reduced to writing the exchange of the Austin assets for petitioner's stock followed by the disposi-

[2] Federal Grain Corp., 18 B. T. A. 242, Samuel Insull, Jr., 32 B. T. A. 47; Schmieg, Hungate & Kotzian, Inc., 27 B. T. A. 337.

tion of petitioner's stock to the public through the medium of the underwriters would have resulted in a taxable gain to the Associates (transferors). Tax Counsel so stated in a written opinion dated May 12, 1936 (R. 72) in which he frankly set out to avoid the consequences of the *Bassick* and *Hazeltine* cases. He stated his opinion that the exchange could be freed from these two controlling decisions only "on the understanding that there is, in fact, no existing agreement between the owners and the bankers and that no agreement, secret or otherwise, will be made before the exchange is made" (R. 75-76). The fact is, however, as expressly found by the Tax Court on overwhelming evidence "All the interested parties orally agreed to the substance of this plan prior to June 2, 1936, though there was no formal written contract between the parties at this time". (R. 119). Hence, the decision of the Court below goes beyond even the expectations of Tax Counsel in its upholding the tax exemption of the exchange in 1936 merely because the agreement of the parties was not reduced to writing.

3. The judgment of the Court of Appeals expressly relying upon Judge Hill's opinion (R. 143) leaves the law controlling taxability of exchanges and reorganizations in a state of chaos. In a host of previous decisions the Tax Court and the Appellate Courts have repeatedly *refused* to determine tax consequences upon the situation as it existed after one of a series of related steps in an exchange or reorganization transaction. As stated in *Peoples Water and Gas Company v. Comm.* (T. C. Memo. Decision), Docket No. 11837, entered June 1, 1948:

> "It is well recognized that where a series of transactions were in fact merely steps in carrying out a definite pre-conceived purpose, the object sought and obtained must govern and the integrated steps used in effecting the desired result may not be treated separately for tax purposes either at the instance of the taxpayer or the taxing authority or by agreement be-

tween both. *Koppers Coal Co.*, 6 T. C. 1209 (Dec. 15, 179); *Illinois Water Service Co.*, 2 T. C. 1200 (Dec. 13, 637); *Commissioner v. Ashland Oil & Refining Co.*, 99 Fed. (2d) 588 (38-2 USTC Par. 9580); certiorari denied, 306 U. S. 661; *Prairie Oil & Gas Co. v. Motter*, 66 Fed. (2d) 309 (3 USTC Par. 1142); *Tulsa Tribune Co. v. Commissioner*, 58 Fed. (2d) 937 (5 USTC Par. 1535); *Anheuser-Busch, Inc.*, 40 B. T. A. 1100 (Dec. 10, 923); affirmed 115 Fed. (2d) 662 (40-2 USTC Par. 9802); certiorari denied, 312 U. S. 699; *Ahles Realty Corporation v. Commissioner*, 71 Fed. (2d) 150 (1934 CCH Par. 9326); certiorari denied, 293 U. S. 611. It is a general rule that taxation is a practical matter dealing not with mere form but rather with the realities. *Commissioner v. Court Holding Co.*, 324 U. S. 331 (45-1 USTC Par. 9215); *Meurer Steel Barrel Co. v. Commissioner*, 144 Fed. (2d) 282 (44-2 USTC Par. 9423); certiorari denied, 324 U. S. 860; *Allen v. Trust Company of Georgia*, 326 U. S. 630 (46-1 USTC Par. 10,254). As we pointed out in the *Illinois Water Service Co.*, supra, 'It is, therefore, the situation at the beginning and end of the transactions to which we must look and determine whether there has been a reorganization within the meaning of the statute, or merely a sale or taxable exchange'."

The Tax Court says and the Commissioner argues that looking at the situation *immediately after the exchange* the Associates were in control of petitioner. But to so interpret section 112 (b) (5) would be to apply "inert language" as the criteria of tax liability. *Bazley v. Commissioner, supra.*

So far has the Tax Court departed from reason, logic and precedent in petitioner's case that it makes the following startling statement (R. 127): "Statutory words 'immediately after the exchange' require control for no longer period; *in fact, momentary control is sufficient.*" The Board of Tax Appeals long ago spiked that sweetly sound-

ing notion. In *Omaha Coca-Cola Bottling Co. v. Connor*, 26 B. T. A. 1123, assets were transferred to a corporation for its stock under a plan which called for a retransfer of the stock to the corporation for cash. The Board of Tax Appeals held that, though "immediately" after the exchange, the transferor of the property was in control of the corporation, the transaction was *not* a tax free exchange because "the transaction must be considered in its entirety, and effect must be given to the whole." The Board of Tax Appeals there relied on its previous decision in *West Texas Refining and Development Co.*, 25 B. T. A. 1254, where a corporation issued stock in payment of property and sixteen days later the stock was taken over for cash. The Board of Tax Appeals there said:

> "Where there are several steps to be taken in effecting the organization of a new corporate enterprise, it is impossible to have them all occurring at the same moment. One step must precede another and we do not think the language of section 203, 'immediately after the transfer' intended that questions of tax liability should be determined by the fact that a transfer of property occurred a few days before cash was paid in, where both are *essential steps in the plan of organization.*"

That neither the delay in the transfer by the Associates of the petitioner's stock after the exchange nor the so-called "contingency" of the sale by the underwriters to the public are significant either singly or in combination is apparent from a previous Tax Court decision. In *W. N. Fry*, 5 T. C. 1058, 1071, the Court stated:

> "Substantial delay in the stock distribution was inevitable in the 'workout' of the plan. The stock was to stand pledged to R. F. C. until the borrowed funds with which it was acquired were repaid or other arrangements made for its partial or total release. When such partial release was obtained, pro rata distribution according to the plan was made immediately. Mere

delay in such distribution, where due to reasonable cause, is immaterial, *once the existence of the plan is established. D. W. Douglas,* 37 B. T. A. 1122; *Hortense A. Mengee,* 46 B. T. A. 865 and authorities cited therein."

The *Douglas* case, there cited, is further authority for the holding that the postponement of a plan's execution "until it could be carried out in full" is of no consequence in determining taxability of exchanges.

In petitioner's case, the delay in the transfer of the stock out of the hands of the Associates was a perfectly good reason and was all part of the prearranged plan. The Austin plant had been idle at the time of the transfer (R. 20, 88). There was no point to the transfer of the Austin plant to a *newly organized corporation without working capital.* The Associates supplied the plant and the public was intended to supply the working capital by means of the financing arrangements with the underwriters. Now, while these financing arrangements *might have failed* if the public refused to invest in petitioner's stock, the fact is that the public *did* invest and the working capital was thus obtained. Hence, the so-called "contingency" passes out of the picture. It took some time for the Associates thus to dispose of their stock to the public and the underwriters. But the disposition of the stock held by the Associates was part and parcel of the plan to which "*all* the interested parties orally agreed" (R. 119).

Even Judge Hill has not previously regarded the meaning of "control immediately after the exchange" as a matter of comparing the facts with "inert language." In *Aviation Manufacturing Corp.,* Docket No. 754, P-H 1944 T. C. Memo. Par. 44,089, there were both delay and so-called "contingency" in the disposition of the stock after the exchange occurred. Judge Hill there said:

> "While admitting that the whole plan envisaged the original issue of 787,500 shares of the transferee's stock, petitioner contends that the transfer here comes

within the ambit of the quoted sections of the statute since petitioner and its stockholder owned at least 80 percent of the transferee's outstanding stock from November 14, 1939, the date the assets were transferred, until January 12, 1940 when 300,000 shares were sold to underwriters.

"Were we to shut our eyes to the object which the reorganization provisions of the statute are intended to accomplish, the literal terms of the subsections upon which petitioner relies might warrant our sustaining his position. However, we would not be justified in disregarding the patent intent and purpose of a statute in interpreting its meaning as applied to a given state of facts."

* * * * * *

"The fact that at one point in the proceeding petitioner or its stockholder did own all the then outstanding stock of the transferee corporation is not compliance with sections 112 (g) (1) (C) and (h). For income tax purposes, the component steps of a single transaction can not be treated separately. *Bassick v. Commissioner,* 85 F. (2d) 8; *Helvering v. New Haven & S. L. R. Co., Inc.,* 121 F. (2d) 985; *Robert M. Morgan,* 41 BTA 379, affirmed 117 F. (2d) 334. The question of control is to be determined by the situation existing at the time of the completion of the plan. *Case v. Commissioner,* 103 F. (2d) 283; *West Texas Refining & Development Co. v. Commissioner,* 68 F. (2d) 77; *Halliburton v. Commissioner,* 78 F. (2d) 265; *W. & K. Holding Corporation,* 38 BTA 830. When the transaction, including therein the several successive steps, was finally consummated, the Aviation Corporation, petitioner's stockholder, owned not over 450,000 shares of the transferee corporation's authorized original issue of 787,500 shares of capital stock. This was substantially less than the required control as defined by section 112 (h). Hence, there was no reorganiza-

tion within the meaning of Section 112 (g) (1) (C) as would invoke the operation of section 112 (b) (4)."

The Aviation decision cannot be reconciled with that in petitioner's case so far as delay and so-called "contingency" in the disposition of the stock after the exchange are concerned.

This is an indication of the confusion into which the law has now been thrown as a result of the decision in this case, which seemingly overrules without saying so what the Tax Court and the Courts of Appeal have long enumerated as controlling principles.

3. Petitioner submits that the error of the Court below is of sufficient national importance to warrant review; and that following review by this Court the case should be remanded to the Tax Court to make the essential finding (Sections 113 (a), 114 (a) of Revenue Act of 1936; 26 U. S. C. A. Int. Rev. Acts, 1924 to Date, pp. 859, 866) of the cost to petitioner of the assets. *Lewis v. Commissioner,* 160 F. 2d 839 (C. A. 1). The Tax Court's refusal to make such finding was the result of its erroneous conclusion that the transaction here involved was tax free.

4. It is clear that the question here involved is a recurring one. The question in this case is important and should be settled by this Court.

It would seem that, from an administrative point of view, the respondent would welcome review, particularly since the net effect of the holdings of the Tax Court and the Court of Appeals may well lead to substantial tax avoidance. For example, a taxpayer who wishes an exchange not to be free from recognition of gain or loss so that he can take a *loss* on the transaction can assure that result by arranging to enter into a written contract for the subsequent sale of the stock *before* the exchange takes place. But, if a gain is involved and the taxpayer wants to avoid tax he can arrange the transaction so the written contract for subsequent disposition of the stock is executed *after* the exchange. In that way, tax liability could be deter-

mined in advance by arranging the proper timing for the execution of the written contract which the Tax Court and the Court of Appeals (by wholly adopting Judge Hill's opinion) now say is controlling.

Conclusion.

Because the decision of the court below is in conflict with those of other Circuits squarely on point as well as with other pertinent Tax Court decisions; because the decision of the court below violates the reasoning frequently expressed by this Court in pertinent tax cases; because it erroneously makes tax consequences turn on mere formalisms; and because the question involved is an important and recurring one, it is respectfully submitted that the petition for writ of certiorari should be granted.

AMERICAN BANTAM CAR COMPANY,
Petitioner.

By its counsel:
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In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 589

AMERICAN BANTAM CAR COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 116a–137a) are reported at 11 T. C. 397. The opinion of the Court of Appeals (R. 143) is reported at 177 F. 2d 513.

JURISDICTION

The judgment of the Court of Appeals was entered November 14, 1949. (R. 144.) The petition for certiorari was filed February 10, 1950. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Whether the exchange under which the taxpayer's assets were acquired was one in which neither gain nor loss was to be recognized under

Section 112 (b) (5) of the Revenue Act of 1936 so that the basis of the assets was their basis in the hands of the transferors pursuant to Section 113 (a) (8) (A) of the Internal Revenue Code.

STATUTES INVOLVED

Internal Revenue Code:

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(8) *Property acquired by issuance of stock or as paid-in surplus.*—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section 112 (b) (5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), or

* * * * *

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

* * * * *

(26 U. S. C. 1946 ed., Sec. 113.)

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

* * * * *

(b) *Exchanges Solely in Kind.*—

* * * * *

(5) *Transfer to corporation controlled by transferor.*—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

* * * * *

(h) *Definition of Control.*—As used in this section the term "control" means the ownership of stock possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

* * * * *

STATEMENT

The facts as stipulated (R. 16a–87a) and as found by the Tax Court (R. 118a–123a) may be summarized as follows:

On August 21, 1935, the liquidating trustee of the American Austin Car Company sold the assets of Austin to R. S. Evans, Martin Tow, and W. A. Ward, Jr. (hereinafter collectively called the "associates"), for the price of $5,000 cash. The assets were bought subject to certain liabilities of Austin in the amount of $219,099.83. (R. 118a.) A general plan of organizing the taxpayer to take over the Austin assets from the associates was conceived in May, 1936. The plan contemplated the organization of a Pennsylvania corporation to be known as the American Bantam Car Company. The salient points of the contemplated plan included the following: The associates were to receive in exchange for their transfer of Austin assets to taxpayer 300,000 shares of no par common stock, which would comprise all of the taxpayer's stock upon its issuance to the associates; transfer to taxpayer of such assets would be subject to liabilities totaling $219,099.83; 90,000 shares of taxpayer's preference stock would be offered to the public at $10 a share; the underwriters of such issue of preferred stock were to receive from the associates, in addition to their underwriting discounts and commissions, and as further compensation for their services as underwriters, certain amounts of the common stock issued to the associates as and if they effected sale to the public of certain amounts of the preference stock. All the interested parties orally agreed to the substance of this plan prior to June 2, 1936,

though there was no formal written contract between the parties at this time. (R. 118a–119a.)

On June 2, 1936, taxpayer was incorporated under the laws of the Commonwealth of Pennsylvania with an authorized capital stock of 700,000 shares, consisting of 100,000 shares of preference stock of the par value of $10 per share, and 600,000 shares of common stock without par value. (R. 119a.)

Taxpayer's articles of incorporation provided (R. 119a–120a):

> At all meetings of stockholders the holders of preferred stock shall be entitled to 3 votes for each share of preferred stock held by them, and the holders of common stock shall be entitled to 1 vote for each share of common stock held by them.

On June 3, 1936, the associates transferred to taxpayer the Austin assets subject to liabilities which at the time amounted to $219,099.83, together with the sum of $500 in cash and, simultaneously therewith, taxpayer issued to the associates 300,000 shares of its common stock in proportion to their respective interests in these properties. (R. 120a.)

On June 8, 1936, taxpayer executed a written contract with Dingwall & Company, Inc., a New York corporation, and Tooker & Company, a partnership, providing for an irrevocable and exclusive selling order on 90,000 shares of taxpayer's convertible preference stock for a period of six

months from the effective date granted by the Securities Exchange Commission at a public offering price of $10 per share less commissions of 15 per cent and allowance expenses of 5 percent. The following selling schedule was provided: 20,000 shares during the first two months after the effective date granted by the Securities Exchange Commission, 15,000 shares during the third month after such date, 17,500 shares during the fourth month after such date, 17,500 shares during the fifth month after such date, and 20,000 shares during the sixth month after such date. If Dingwall & Company, Inc., and Tooker & Company failed to execute the selling order in accordance with this schedule, taxpayer was given the option to cancel the selling order on ten days' notice. (R. 120a–121a.)

On June 8, 1936, concurrently with the above contract, the associates entered into a written contract with (a) Dingwall, (b) James Botz, who was a partner in Tooker & Company, and (c) Edgar S. Grant, a wholesaler for Dingwall. In substance the associates agreed to deliver to the Butler County National Bank & Trust Company of Butler, Pennsylvania, certificates for 100,000 shares of common stock endorsed in blank for transfer to the underwriters. The underwriters were to be entitled to receive the stock in the amounts and at the times stated as follows: 22,500 shares of common stock when 20,000 shares of convertible preference stock had been sold, 16,500

shares of common stock when the next 15,000 shares of such convertible preference stock had been sold, 19,500 shares of common stock when the next 17,500 shares of such convertible preference stock had been sold, 19,500 shares of common stock when the next 17,500 shares of such convertible preference stock had been sold, and 22,000 shares of common stock when the next 20,000 shares of such convertible preference stock had been sold. (R. 121a.)

It was provided that in the event the selling order contained in the agreement between the taxpayer and Dingwall & Company, Inc., and Tooker & Company was cancelled pursuant to the cancellation provisions mentioned, then this agreement should likewise be cancelled with respect to the shares of common stock to which the underwriters had not become entitled at the end of the notice of cancellation. (R. 121a–122a.)

During the year 1936 only 14,757 shares of the preferred stock was sold by the underwriters. Finally, Grant & Company succeeded Dingwall & Company, Inc., and Tooker & Company as underwriters. Between October, 1936, and October, 1937, Grant sold 83,618 shares of convertible preferred stock to the public for $866,410 (there were no sales of convertible preferred stock between June 2, 1936, and October, 1936). There was no sale of common stock from June 3, 1936, to October 1, 1937. By October 31, 1937, Grant

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had sold 1,008 shares of common stock to the public. (R. 122a.)

During October, 1937, the associates, pursuant to their agreement with the underwriters of June 8, 1936, transferred to Grant 87,900 shares of taxpayer's common stock out of the 300,000 shares previously issued to them. (R. 123a.)

Taxpayer's stocks were held on October 31, 1937, in the following manner (R. 123a):

	Associates	Public	Grant
Common stock	212,100	1,008	86,892
Preferred stock		83,618	

In all of the income tax returns filed by the taxpayer for its taxable years through June 30, 1941, its basis for the assets acquired from the associates on June 3, 1936, was stated to be $145,075.66. For the taxable years ending, respectively, June 30, 1942, and June 30, 1943, in which taxpayer showed profit from war production, taxpayer stated the basis of Austin assets to be $840,800. (R. 123a.)

The Commissioner and the Tax Court determined that the taxpayer, in computing depreciation deductions, was required to use as the basis of its assets the basis in the hands of the transferors (R. 116a–138a). The Court of Appeals affirmed (R. 143–144).

ARGUMENT

The petition for certiorari involves only the application of settled principles of law to the

particular facts of the case. The appellate court's *per curiam* affirmance of the unanimous Tax Court decision was correct, involves no conflict of decisions, and raises no questions warranting further review.

1. The single issue presented was whether the taxpayer, in computing depreciation deductions, was required to use as the basis of its assets the basis in the hands of prior transferors. The lower courts recognized that the taxpayer was so required because the exchange whereby its assets were acquired was one in which neither gain or loss was to be recognized under Section 112 (b) (5) of the Revenue Act of 1936, *supra*, which provides, among other conditions, that "immediately after the exchange" the transferors must be in "control"[1] of the corporation. The determination that the transferors possessed the requisite control was patently correct for immediately after the exchange they were the outright owners of one hundred per cent of taxpayer's stock.[2]

[1] Section 112 (h) provides as follows:

(h) *Definition of Control.*—As used in this section the term "control" means the ownership of stock possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

[2] The taxpayer itself, in all its tax returns until 1941, stated the basis of the assets to be their basis in the hands of the transferors. In 1942 and 1943, when taxpayer showed a large war profit, it attempted to increase the basis. (R. 123a.)

The exchange pursuant to which the assets involved were acquired by taxpayer took place on June 3, 1936. (R. 23a.) On that date the "associates", consisting of R. S. Evans, Martin Tow and W. A. Ward, Jr., transferred to the taxpayer, together with $500 in cash, assets which they had previously purchased from the liquidating trustee of the Austin Company. Upon receipt of the assets, which were subject to liabilities in the sum of $219,099.83, the taxpayer simultaneously issued to the associates 300,000 shares of common stock. (R. 23a–24a.) Prior to the actual exchange a plan had been formulated under which three underwriters would offer to the public 90,000 shares of preferred stock to be issued by the taxpayer, and would receive as compensation, in addition to discounts and commissions, certain amounts of the common stock to be issued to the associates, this to be contingent on the sale by the underwriters to the public of various amounts of the preference stock. (R. 27a–28a, 55a–56a.) Although all of the interested parties had reached an oral understanding as to the substance of the plan prior to June 2, 1936, the date of taxpayer's organization, no written contract was consummated until June 8, 1936, or five days after the corporation issued its common stock to the associates. (R. 25a.) There was, according to the Tax Court's finding, no binding enforceable contract prior to the actual transfer and stock issue (R. 130a) with

the consequence that immediately after the transfer the associates owned and controlled 100 per cent of taxpayer's stock unfettered by any legal obligation to divest themselves of that control.[3]

Moreover, and of greater importance, the agreement between the associates and underwriters at no time contemplated or provided that the associates would be divested of control immediately after the exchange, nor did it grant to the underwriters the unqualified power to attain any portion of the transferees' stock. On the contrary it provided only that the underwriters might, subsequent to the exchange, obtain a substantial portion of the common stock from the associates only when and if they succeeded in earning that stock by sales to the public of preferred stock to be issued by the new corporation. Consequently, the ultimate acquisition of common stock by the underwriters was contingent and indeed highly speculative. On June 3, 1936, the associates were issued 300,000 shares of stock unconditionally and absolutely and no strings

[3] It is basic contract law that where a written contract is executed after elaborate negotiations have terminated in oral agreement, either of two inferences is possible: either the parties intended the written contract to stand only as a memorial of the prior binding agreement; or they considered the execution of the written contract to represent the final and necessary step in the consummation of a binding legal agreement; the Tax Court whose function it is to resolve conflicting inferences was justified in concluding that no binding contract existed until June 8, 1936. See R. 47a–52a.

were attached to the issuance of the stock to them. (R. 24a, 126a.) It was provided only that the underwriters would receive 100,000 shares of the common stock issued to and owned by the associates "when, as and if earned." (R. 27a, 51a.) The underwriters' claim to the stock was neither immediate nor unqualified. The associates were given the power to cancel the selling order if the underwriters' selling schedule were not maintained. (R. 56a.) The effect of this cancellation would be to similarly nullify the rights of the underwriters to any bonus stock to which they had not as yet become entitled. (R. 61a.) The original agreement contemplating the transfer of stock in equal proportions to the three underwriters, when and if they earned it, was never carried out. (R. 28a–29a, 60a.) During the entire year 1936 only 14,757 shares of preferred stock were sold; hence, during 1936 none of the underwriters earned the right to any common stock. (R. 25a–26a, 28a.) The associates could have canceled the entire agreement in view of the failure of the underwriters to meet their selling schedule. At the end of 1936 the associates owned and controlled stock having a voting power of 300,000 votes out of a total of 344,271 votes in existence (the 14,757 shares of preferred stock sold to the public each had three votes, thus totalling 44,271 votes). (R. 26a.) Thus at the end of 1936, or more than six months after the issuance of the taxpayer's stock in

return for the assets transferred to it by the associates, the associates still possessed "control" of the taxpayer as defined by the statute. Only Grant & Company of the original three underwriters succeeded in selling the preferred stock in any reasonable quantities, and Grant & Company "succeeded Dingwall & Co., Inc. and Tooker & Co. as 'Underwriters'." (R. 28a.) Neither of the remaining underwriters ever became entitled to or did in fact receive any stock bonus. (R. 29a.) Not until October 1937, or approximately fifteen months subsequent to the actual exchange, did the associates transfer to Grant & Company 87,900 shares of the common stock. (R. 26a.)

The lower courts correctly recognized the interrelationship of the various steps in the setting of a preconceived plan. Under the plan as originally contemplated and as actually carried out, the associates were not to be divested and were not in fact divested of control immediately after the exchange. On the contrary, they were to retain control of the corporation for at least a period of months thereafter and whether or not they would ever be divested of control was a matter of speculation. The question whether, in the light of all the facts, the associates retained control of the taxpayer immediately after the exchange was a factual issue to be determined by the Tax Court on the evidence presented. See *Commissioner* v. *Court Holding Co.*, 324 U. S. 331; *United States* v. *Cumberland Pub. Serv. Co.*,

338 U. S. 451. The Tax Court was clearly justified in concluding (R. 130a) that the exchange and the subsequent relinquishment of taxpayer's stock some fifteen months later "should not be considered part of the same transaction so as to deprive the associates of 'control' immediately after the exchange."

2. The decision involves no conflict with any other appellate court decision. In *Halliburton* v. *Commissioner,* 78 F. 2d 265 (C. A. 9), taxpayers had transferred the assets of their partnership business to a newly organized corporation pursuant to a binding agreement with various oil companies entered into prior to the transfer under which the oil companies were to subscribe to 130,000 of the 350,000 shares of capital stock. The oil companies did subscribe to the stock on the effective date of the corporation's organization. In *Hazeltine Corp.* v. *Commissioner,* 89 F. 2d 513 (C. A. 3), a contract had been consummated prior to the organization of a new corporation and the transfer to it of various assets, providing that of the 155,250 shares of stock to which the transferor would be entitled, 135,000 shares would be simultaneously delivered and assigned to another company; and in fact the 135,000 shares were never issued to the transferor but were immediately issued to the outside company. In *Heberlein Patent Corp.* v. *United States,* 105 F. 2d 965 (C. A. 2), prior to the completion of the transfer to a newly organized corporation of

assets including rights to future patents, a written contract had been consummated whereunder it was agreed that 500 shares of the 10,000 shares of stock to be issued would be issued to an outside company, and furthermore transfer powers had been executed assigning 1,525 shares of the stock to a number of individuals. In *Bassick* v. *Commissioner,* 85 F. 2d 8 (C. A. 2), certiorari denied, 299 U. S. 592, rehearing denied, 299 U. S. 623, a binding contract had been consummated prior to the transfer requiring the transferor to sell to a banking corporation 65,000 shares of the total 147,500 shares of stock issued to it by the new corporation; and further providing for the issuance by the new corporation of an additional 52,500 shares of its stock for the common stock of another company. Cf. *United States* v. *Rodgers,* 94 F. 2d 666 (C. A. 3). In each of these cases there were created prior to the exchanges enforceable rights vesting in parties other than the transferors the unqualified power to attain more that 20 per cent control of the transferee. This fact furnishes the essential distinction between them and the present case. Other cases relied upon by the taxpayer involve factual situations plainly different from that here presented.

CONCLUSION

The petition for certiorari should be denied.

Respectfully submitted.

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